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ENTERTAINMENT AND RELATED DEDUCTIONS UNDER THE REVENUE ACT OF 1962

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ON MAY 28, 1950, Mr. and Mrs. O. Carlyle Brock boarded a plane at Erie, Pennsylvania. They went to London and thence, by way of Paris and Rome, to Africa, stopping briefly in each city to take motion pictures. As soon as they reached Africa they set out on a big-game hunt, in the course of which they killed a number of animals. They made every effort to get the finest specimens available, refraining, for example, from killing any elephants except those whose tusks weighed at least a hundred pounds each. They captured two leopards and a tiger for the zoo at Erie. They spent a considerable portion of their time on the trip writing letters home and taking still and motion pictures. They returned to Erie in November.

The cost of this trip was $16,818.16. All of it was paid by a corporation known as Sanitary Farms Dairy, Inc., and claimed as a deduction (as an advertising expense) on the corporation's 1950 federal income tax return.

Upon audit of this return the Commissioner disallowed all but $1,200 of the amount so claimed and included the disallowed portion in the taxable income of Mr. and Mrs. Brock. The taxpayers petitioned the Tax Court on these issues. Having examined all of the facts, that body decided that the Commissioner was wrong, that the cost of the trip was deductible "as a relatively small part of the advertising program carried on by the Dairy," and that no increase in the Brocks' taxable income on account thereof was required.[1]

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1. Sanitary Farms Dairy, Inc., 25 T.C. 463, 468 (1955), acq., 1956-2 Cum. Bull. 8. The court found as a fact that the Brocks' safari had been suggested as an advertising device and so executed. An enormous amount of free newspaper coverage was accorded the departure and return of the hunters, the progress of the hunt and the presentation of the leopards and tiger to the zoo. The letters and still pictures sent from Africa were published not only in the Dairy's house organ but also in the local press. A "name-the-tiger" contest was carried on through the newspapers. The animals killed were put on display in a museum at the plant. Motion pictures taken in Africa were shown free in various auditoriums in Erie to nearly 180,000 people. A pamphlet describing the safari was distributed. In all of this the name of the dairy was prominently displayed. The court held "that advertising of equal value . . . could not have been obtained for the same amount of money in any more normal way." 25 T.C. at 467. Although acquiescing in this decision, the Internal Revenue Service warned that "due to the unique and exceptional nature of that case, . . . it will be strictly applied. Therefore, the policy of the Internal Revenue Service will be to allow a deduction only in those cases where the facts and circumstances are substantially

In 1961, President Kennedy recommended the complete abolition of deductions of the cost of business entertainment and the maintenance of entertainment facilities. "Too many firms and individuals," he said, "have devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government."[2]

In support of the President's proposal, the case of the Brocks' hunting expedition was cited as a particularly flagrant example of abuse. A memorandum prepared by the Internal Revenue Service flatly stated that

> when existing law allows the cost of a safari to Africa, undertaken by a hunting enthusiast and his wife, to be deducted on the ground that it provides advertising for dairy milk, one cannot expect revenue agents to successfully question the business necessity for duck hunting or night-clubbing with business associates.[3]

Congress agreed with the President and the tax authorities that there were abuses in the deduction of entertainment and similar expenses, and undertook to do something about them.[4] It refused, however, to do as much as the President had requested. In the words of the Senate Finance Committee, Congress was

> convinced that expenses incurred for valid business purposes should not be discouraged since such expenses serve to increase business income, which in turn produces additional tax revenues for the Treasury. If valid business expenses were to be disallowed as a deduction (particularly expenses associated with selling functions), there might be a substantial loss of revenue where business transactions are discouraged, or where they failed to be consummated. Moreover, the entertainment industry employs large

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identical to the facts and circumstances in that case." Rev. Rul. 56-583, 1956-2 Cum. Bull. 117. The Tax Court, itself, has said "that advertisements do not have to directly praise the taxpayer's product" if they tend "to create goodwill and to place the name of the advertiser before the audience of the medium used." Denise Coal Co., 29 T.C. 528, 553 (1957), aff'd in part and rev'd in part on other issues, 271 F.2d 930 (3d Cir. 1959). On the other hand, a taxpayer engaged in the safe and lock business is not entitled to an advertising expense deduction for the cost of maintaining parade horses where there was no evidence that advertising material was used in connection with the parades that would publicize the business. There must, the court said, be "evidence . . . that the business was advertised and that there was a reasonable expectation that the business would benefit." Lucien W. Rolland, 18 CCH Tax Ct. Mem. 702, 706 (1959), aff'd per curiam, 285 F.2d 760 (5th Cir. 1961).

2. H.R. Doc. No. 140, 87th Cong., 1st Sess. 10 (1961). When the Treasury came to give a detailed description of the President's proposals, it appeared that a few extremely limited exceptions to the total disallowance of entertainment deductions were acceptable. Hearings on the Tax Recommendations of the President Before the House Committee on Ways and Means, 87th Cong., 1st Sess. 283-85 (1961) [hereinafter cited as House Hearings].

3. House Hearings 166.

4. H.R. Rep. No. 1447, 87th Cong., 2d Sess. 19 (1962) [hereinafter cited as H.R. Rep. No. 1447].

numbers of service personnel, most of whom are unskilled workers who would find it difficult to obtain new employment in other fields if the disallowance of entertainment expenses created considerable unemployment in the entertainment industry. In such cases, taxes now paid by these workers would be lost to the Treasury.[5]

Congress proceeded therefore on the premises, first, that entertainment and similar expenses might be either good or bad, and, second, that deductibility should be denied only for those that were bad. To this end, what the legislators attempted was a limitation on deductions through the addition of new and presumably stricter standards to those already established.

The expenses incurred in carrying on a trade or business or for the production of income have never been and will not now be deductible unless they are "ordinary and necessary."[6] But to the extent that any such expense is described in the new Section 274 of the 1954 Internal Revenue Code, it will also have to meet the requirements of that provision.

Section 274 concerns itself with three types of expenditure:

First, any item with respect to "an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, . . . " including charges for "a facility used in connection with" such an activity;[7]
Second, any expense for gifts;[8] and
Third, the expense of travel away from home.[9]

I. Entertainment Expenses

In the context of the new law, entertainment, and so forth, includes "any business expense incurred in satisfying the personal, living, or family needs of any individual. . . . "[10] Examples of this are the furnishing of food and beverages, a hotel suite, or an automobile, as well as the conventional theater or sporting event ticket or evening at a night club.[11] Although there will be some reference to the business of the

5. S. Rep. No. 1881, 87th Cong., 2d Sess. 25 (1962) [hereinafter cited as S. Rep. No. 1881].

6. Int. Rev. Code of 1954, §§ 162, 212. Cf. Int. Rev. Code of 1939, ch. 1, § 23(a), 53 Stat. 12, as amended by Revenue Act of 1942, ch. 619, § 121(a), 56 Stat. 819. The "ordinary and necessary" test made its first appearance in the Revenue Act of 1918, ch. 18, § 214(a)(1), 40 Stat. 1066. The earlier acts referred to "necessary expenses actually paid in carrying on any business . . . ." Tariff Act of 1913, ch. 16, § II B, 38 Stat. 167.

7. Int. Rev. Code of 1954, § 274(a)(1).

8. Int. Rev. Code of 1954, § 274(b).

9. Int. Rev. Code of 1954, § 274(c).

10. H.R. Rep. No. 1447, at 20. This definition was dropped without explanation from the corresponding text of the Finance Committee. S. Rep. No. 1881, at 27.

11. H.R. Rep. No. 1447, at 20.

taxpayer to ascertain whether he was really engaged in entertaining (a drama critic taking someone to the theater would not be so engaged, nor would a dress designer inviting his customers to a fashion show), objective standards are supposed to govern. Accordingly, it is expected to be impossible to escape the new criteria by, for example, calling entertainment advertising.[12]

Deductions for the cost of entertainment-type activities will hereafter be allowed only if and to the extent that the taxpayer is able to establish either:

(a) that his expenditure was "directly related" to the "active conduct" of his trade or business; or
(b) if the entertainment directly preceded or followed "a substantial and bona fide business discussion," that his expenditure was "associated with" such "active conduct."[13]

To be either "directly related to" or "associated with" the active conduct of a trade or business, an entertainment expenditure must be shown to have "a greater degree of proximate relation" to the business than was required under pre-1962 law.[14] In both cases, apparently, the taxpayer will have to demonstrate "more than a general expectation of deriving some income at some indefinite future time" as a ground for incurring the expense.[15] Although "he will not be required to show that income actually resulted from each and every expenditure,"[16] our taxpayer will not get his deduction "where the possibility of the expenditure resulting in the production of income is remote. . . . "[17] An example of such remoteness cited in the Finance Committee Report is that of the taxpayer who has more business than he can handle and who nevertheless goes on entertaining buyers. Under the new law, he will engage in such entertainment without benefit of deduction.[18]

12. H.R. Rep. No. 1447, at 20, A29. The Ways and Means Committee said that "the particular business of the taxpayer will be considered in applying this objective test." Id. at 20. The Finance Committee said that the taxpayer's trade or business "will determine" the character of the activity. S. Rep. No. 1881, at 27.

13. Int. Rev. Code of 1954, § 274(a)(1)(A).

14. H.R. Rep. No. 1447, at 20; S. Rep. No. 1881, at 28.

15. H.R. Rep. No. 1447, at 20; cf. S. Rep. No. 1881, at 28.

16. H.R. Rep. No. 1447, at 20.

17. S. Rep. No. 1881, at 28.

18. Ibid. Accord, Victor Cooper, 8 CCH Tax Ct. Mem. 689 (1949), aff'd per curiam, 184 F.2d 514 (3d Cir. 1950). The inability of the taxpayer to accept new business was one of the grounds given for the partial disallowance of entertainment deductions in James Schulz, 16 T.C. 401, acq., 1951-2 Cum. Bull. 4. However, the opinion gives the impression that the court was much more concerned with the nature of the entertainment than the taxpayer's inability to derive an immediate benefit therefrom. "There is little," said Judge Arundell,

Entertainment will meet neither of the new tests if it is lavish or extravagant, if it contravenes public policy as expressed by local law, or if it is immoral.[19] It will also in most instances fall short of the requirements to the extent that its beneficiaries include the wives or members of the families of either taxpayers or their customers.[20] Thus, where wives are among those entertained, although their presence may not prevent a deduction of some of the cost of the party, that portion of such cost attributable to them will not be deductible.[21]

The principal distinction between the "directly related" and "associated with" tests appears to lie in the nature of the entertainment itself. To be directly related to a business, entertainment must be of a kind that could be accompanied by negotiations related to that business. Direct relationship will be presumed absent if, because of the circumstances of the entertainment, it is unlikely that such concurrent negotiations were possible. If the taxpayer himself was not present, if the group of persons entertained was large or if the distractions were substantial, the presumption against direct relationship will be invoked.[22] But this is a rebuttable presumption and it would seem that, in spite of disclaimers by the Commissioner of Internal Revenue, the taxpayer here will be well advised to strengthen his case with proof that business

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"to distinguish these occasions from the usual social gatherings among friends to renew acquaintanceship and enjoy a pleasant evening. They bear little semblance to the usual gatherings of business people at restaurants or other places of entertainment which serve primarily as congenial meeting places for the discussion or negotiation of business matters." 16 T.C. at 405. Under the "associated-with" test of the new law, Mr. Schulz, who had apparently spent part or all of the day before each of these evening gatherings in conference with the persons entertained (telling them he had nothing to sell them) might well be allowed to deduct the expense of the entertainment.

19. S. Rep. No. 1881, at 28-30. An example of an expense contrary to public policy is the cost of liquor purchased in a dry state. Id. at 29. The courts have already declared such an item nondeductible. Al J. Smith, 33 T.C. 861 (1960); United States v. Winters, 261 F.2d 675 (10th Cir. 1958). The cost of providing "call girls" is an example of an immoral expense. There has heretofore been no case involving a claimed deduction for such an item but there have been many in which expenditures for illegal purposes were held nondeductible. See 4 Mertens, Federal Income Taxation § 25.132 (1960 rev.).

20. S. Rep. No. 1881, at 28, 30.

21. The Conference Report gives two examples of entertainment at which wives are present and declares that the "entertainment expenses, if associated with the active conduct of the taxpayer's business, will be deductible . . . ." H.R. Rep. No. 2508, 87th Cong., 2d Sess. 16 (1962) [hereinafter cited as Conf. Rep. No. 2508]. The report adds that the Finance Committee had described "the conditions under which an item is 'associated with' the active conduct of a trade or business . . . ." Ibid. The Finance Committee made it crystal clear that wives' entertainment would rarely if ever meet these conditions. S. Rep. No. 1881, at 28-30.

22. H.R. Rep. No. 1447, at 21.

was actually transacted. Some such device as the tape recordings now being offered by a few restaurants should meet the case very nicely.[23]

If the entertainment occurs immediately before or after a substantial and bona fide business discussion, it will be immaterial that the taxpayer was absent; the number of his guests will have no significance; and the entertainment may have been as diverting as the guests could stand. The proximity of an antecedent or subsequent business discussion will make it possible to provide entertainment during which a business discussion could not possibly occur.[24]

It must be stressed that even though in the "directly related" cases the taxpayer will have to show that a business discussion could have taken place, there is no requirement under either the directly-related or associated-with test that such a discussion did in fact take place.[25]

Is there more of a distinction than this? The Finance Committee, which introduced the "associated with" test, described it as permitting good-will entertainment.[26] The conferees also expressed such an understanding.[27] But in stressing the need for an expectation of income both for directly-related and associated-with entertainment, the Committee seems clearly to have eliminated deductions for the entertainment of persons who are not yet customers and whose custom is merely a hope in the heart of the taxpayer.

One of the curious lacunae in the new law is its failure to dispose conclusively of the question of the cost of the taxpayer's own entertainment. For some years, it has been an article of faith among "tax wallahs"[28] that a businessman who takes a customer to lunch may deduct (a) the cost of the customer's lunch, and (b) the difference between the cost of the businessman's own lunch and what he would have spent if he had been eating alone. The faith received judicial imprimatur in 1953 by way of dictum in the Tax Court's decision in *Richard A. Sutter*,[29] and at least some writers have treated this as a

23. Wall Street Journal, Feb. 6, 1963, p. 2, col. 3. The report quotes from a speech made in January, 1963, by the Commissioner in which he said, "there is the exception for the quiet business meal. You don't have to talk business there, but the person who is your guest must be the one who is the natural object of your business attention." It is by no means certain that the Commissioner did not here introduce a new test for deductibility.

24. Conf. Rep. No. 2508, at 16.

25. Staff of House Committee on Ways and Means, 87th Cong., 2d Sess., The Revenue Act of 1962, at 3-4 (Comm. Print 1962); see also note 23 supra.

26. S. Rep. No. 1881, at 28.

27. Conf. Rep. No. 2508, at 16.

28. This term is defined in Knickerbocker, Life Insurance and Federal Taxes, 43 Cornell L.Q. 419 n.1 (1958).

29. 21 T.C. 170, 174 (1953), acq., 1954-1 Cum. Bull. 6.

rule of law. However, in its proposed regulations on the substantiation of entertainment expenses published last November, the Internal Revenue Service rather clearly rejected the *Sutter* rule.[30] The final regulations retreated from this rigid position and the question today is as hazy as it ever was.[31]

For the purposes of section 274, the term "trade or business" includes the production or collection of income and the management, conservation or maintenance of property held for the production of income—the activities, that it, whose ordinary and necessary expenses have heretofore been deductible under Code section 212.[32] This inclusion makes acute the problem created by section 274's use of the words "active conduct" which in each case precede "trade or business." "Active conduct" is a term of art. As used in other Code sections, including those dealing with spin-offs,[33] Western Hemisphere Trade Corporations[34] and, most recently, Controlled Foreign Corporations,[35] the words clearly exclude the collection of so-called "passive" income. For example, the proposed regulations under Section 954 of the Code distinguish between rent collected by a lessor that acts as its own agent and employs a substantial staff to manage and maintain its property, and rent collected by a lessor for whom an estate management firm performs all such functions. The second kind of rent is not deemed to have been derived in the active conduct of a business.[36]

Also excluded from the traditional concept of active conduct is any operation that is not independent in the sense that it includes "all of the elements necessary to produce income."[37]

If these exclusions are applied under section 274 it seems unlikely that entertainment deductions will any longer be available to many investors, or even to some businessmen. Consider, for example, an individual whose income consists entirely of interest and dividends derived from a portfolio supervised by an investment counsellor. Can

30. Proposed Treas. Reg. § 1.274-5(c)(6), Example (2), 27 Fed. Reg. 10897 (1962). See also note 88 infra.

31. Treas. Reg. § 1.274-5(c)(6) (1962). This subparagraph is now entitled "Special rules" and all examples have been dropped. There is, however, a somewhat equivocal reference to the allocation of the total cost of entertainment among the persons present "if such determination is material."

32. Int. Rev. Code of 1954, § 274(a)(2)(B).

33. Int. Rev. Code of 1954, § 355(b)(1).

34. Int. Rev. Code of 1954, § 921(2).

35. Int. Rev. Code of 1954, § 954(c)(3)(A).

36. Proposed Treas. Reg. § 1.954-2(c)(3), Examples (4) & (5), 27 Fed. Reg. 12764 (1962). Cf. Treas. Reg. § 1.355-1(c)(1) (1955); Treas. Reg. § 1.921-1(a)(3) (1957).

37. Rev. Rule 57-492, 1957-2 Cum. Bull. 247, 248. Cf. Treas. Reg. § 1.355-1(c) (1955).

he entertain the counsellor and expect to deduct the cost? The entertainment may be directly related to the management of the portfolio but the element of active conduct in the traditional sense seems missing. What about the head of a research and development division who engages in entertainment directly related to the work of his division? Can we expect the Commissioner to decide that, in this area at least, research and development is the active conduct of a trade or business?

II. Facilities Costs

Section 274 also disallows deductions for expenses in respect of facilities used in connection with entertainment and similar activities, unless these tests are met:

(a) The facility must be "used primarily for the furtherance of the taxpayer's trade or business"; and

(b) The expense must be "directly related to the active conduct of such trade or business. . . ."[38]

The committee reports indicate that a "facility" is any item of personal or real property owned or rented by the taxpayer.[39] The expenses covered by this rule appear to be maintenance costs, depreciation and the like, and not the direct cost of specific entertainment.[40] They also include, by express Code provision, dues and fees paid to social, athletic, or sporting clubs.[41] In order to have any of these items taken into account for tax purposes under the new law, the facility will have to be used more than fifty per cent in a manner which under pre-1962 law would have resulted in a deduction.[42] If the facility is so used, the maintenance and other costs will be deductible to the extent that the facility is used for entertainment or similar activities directly related to the active conduct of the taxpayer's trade or business.

To illustrate these principles, assume that a taxpayer owns a yacht and that on an application of prior law tests he is found to have used the vessel eighty per cent for business. This satisfies the first requirement. The facility was used primarily for the furtherance of his business. However, on analysis, it appears that half of the yacht's business use consisted of entertaining customers when the taxpayer was absent, or of providing such customers with free vacations—uses, in other words,

38. Int. Rev. Code of 1954, § 274(a)(1)(B).

39. H.R. Rep. No. 1447, at 21; S. Rep. No. 1881, at 31.

40. H.R. Rep. No. 1447, at 21-22. To avoid incurring nondeductible facilities costs some taxpayers, it is reported, have sold their yachts and hunting lodges and plan to rent the same or similar properties only as needed for entertainment directly related to the active conduct of business. Wall Street Journal, Feb. 6, 1963, p. 1, col. 5.

41. Int. Rev. Code of 1954, § 274(a)(2)(A).

42. H.R. Rep. No. 1447, at 22.

that are clearly outside the directly-related category.[43] Assuming that the balance of the business use was directly related to the active conduct of the taxpayer's trade or business, only forty per cent of the total depreciation and other maintenance costs of the yacht can be deducted under the new law. The direct cost of the entertainment deemed to be directly-related would, of course, be fully deductible.[44]

Facilities deductions may be harder to come by than has been imagined. The only business use that will count towards their allowance will be that which meets the strict directly-related test. If a taxpayer entertains at his club or aboard his yacht, he will have to show that he had a genuine expectation of deriving income as a result of that entertainment.

Consider this situation: suppose one of an attorney's clients is a small corporation. During the past month its president and principal stockholder has taken him to lunch at a club four times to discuss a federal income tax deficiency which an examining agent has proposed against the corporation for 1960. It seems clear that the expenses the corporation has incurred in entertaining the attorney will be deductible on its 1963 return. But it is almost as clear that this particular use of the club is not directly related to the corporate business since there is no chance at all that buying a lunch for him will result in income. If the club is used for nothing but this sort of entertainment there will be no deduction for the dues paid.

On the other hand, if the club dues were being paid by the president, his entertaining the attorney would be counted in determining the extent of his deduction. In the controversy, if the corporation loses, the stockholders will also lose because they will then be deemed to have received additional dividends in 1960. Therefore the president's conferences are designed to help not only his company but himself. Code section 274(a)(2)(B) declares that in applying the new entertainment deduction rules "an activity described in section 212 shall be treated as a trade or business." In other words, in the case of an individual, the required direct relationship need not be to a trade or business.[45] It can just as well be a relationship to the collection of income, the management of property held for income *or* the determination, collection or refund of any tax. To the extent, therefore, that the president's conferences with

43. See H.R. Rep. No. 1447, at 22; S. Rep. No. 1881, at 31-33.

44. H.R. Rep. No. 1447, at 22.

45. Literally read, the statute may mean to give all taxpayers the benefit of deductions for the cost of entertainment directly related to, or associated with, the active conduct of § 212-type activities. However, the deductions provided for in § 212 are allowed to none but an individual. I have therefore assumed—very possibly erroneously—that activities of this sort are referred to in § 274 only for individuals.

the attorney have to do with his own tax liabilities, the directly-related test has been met. The dues deduction that the corporation cannot have might very well be available to its president in his individual capacity.

The congressional committees were silent, and the Treasury has spoken only to take it back, on the method of determining the extent of facility use primarily in furtherance of a business or directly related thereto. As originally proposed, the substantiation regulations suggested a time test.[46] If a facility was used during one hundred days of the year and the use on fifty-one of such days was found to be primarily in furtherance of business, the facility qualified. The final regulations neatly dodge this question.[47] We may therefore have to show not only the number of days or hours of use, but other factors to indicate the extent of use during those days or hours. Thus, on the same assumptions as to days of use, if it appeared that on one day alone there occurred some nonbusiness entertainment that involved more people than were entertained all the rest of the year, the facility might not qualify.

The new rule on facilities is not confined to depreciation and maintenance charges. It is intended also to limit or preclude the deduction of a loss on the sale of property if such property happens to be used in connection with entertainment.[48] Such a facility must be deemed used for personal purposes to the extent that deductions with respect thereto are disallowed by operation of section 274(a).[49] Accordingly, even if the facility has always been used one hundred per cent in furtherance of the taxpayer's business, it will be considered a business asset for 1963 and later years only to the extent that its use was for purposes directly related to that business.

Necessarily, the application of section 274(a) to determining the availability of a loss on the disposition of a facility will create an allocation problem whenever, as will almost always be the case, the facility has been held during more than one taxable year and its percentage of use directly related to the business has varied from year to year. It would seem that the deduction in such a case would be limited to that proportion of the loss which the amount of directly-related use for the entire holding period bears to the total use during that time.

Assuming (but not deciding) that the extent of deductible use will

46. Proposed Treas. Reg. § 1.274-5(c)(6), Example (4), 27 Fed. Reg. 10898 (1962).

47. Treas. Reg. § 1.274-5(c)(6)(iii) (1962): "In order to establish that a facility was used primarily for the furtherance of his trade or business, the taxpayer shall maintain records of the use of the facility, the cost of using the facility, mileage or its equivalent (if appropriate), and such other information as shall tend to establish such primary use."

48. H.R. Rep. No. 1447, at 21-22.

49. Int. Rev. Code of 1954, § 274(g); see also H.R. Rep. No. 1447, at 26.

be determined on a time basis, the following table might illustrate the computation of deductible loss:

Year	Number of Days Used	Business Use	Directly Related	Per Cent Deductible
1963	200	160	120	60%
1964	180	75	75	-0-
1965	240	216	24	10%
Totals	620	451	219	23%

Presumably also, if the first year of the holding period had been 1962 (so that deductibility for that year did not depend on the "directly related" test), eighty per cent rather than sixty per cent of the costs would have been deductible for that year, and the final percentage would be increased to nearly thirty per cent.

The new investment credit under Code section 38 is unavailable except in respect of depreciable property.[50] For this reason, this credit will be allowed (if at all) on account of the acquisition of entertainment facilities only to the extent of their directly-related use. One assumes that this extent will be the directly-related use during the year the facility is acquired. As to the effect of section 274's treatment of facilities on the recapture provisions of section 47,[51] speculation is idle. It may be devoutly hoped, however, that variations in directly-related use from year to year will not be treated as either acquisitions or dispositions for investment credit purposes.

Charges with respect to facilities which are deductible without regard to their business or income-producing connection will not be affected by section 274. Such items as interest, taxes and casualty losses will continue to be deductible even though they do happen to be incurred in connection with an entertainment facility.[52]

It has been suggested that the broad definition of the term "facility" subjects to the rules of section 274 the maintenance and depreciation expenses heretofore deemed deductible on account of automobiles used in business and parts of residences set aside as office space.[53] If this is the case, much more than entertainment expense will have to be disallowed. For example, a doctor who uses his automobile about forty per cent of the time in driving to the hospital or making house calls on

50. Int. Rev. Code of 1954, § 48(a)(1).

51. See Knickerbocker, The New Investment Tax Credit, Prac. Law., Dec. 1962, at 43, 72-78.

52. Int. Rev. Code of 1954, § 274(f).

53. This disquieting suggestion is attributed to V. Henry Rothschild, II, Esq., N.Y. Times, Oct. 14, 1962, § 3, p. 14, col. 4.

his patients will not be entitled to deduct any part of the car's maintenance cost or depreciation because his business use is less than fifty per cent. Also, consider this situation: some years ago, a man who writes for radio convinced the tax authorities that he was entitled, in computing his income, to deduct about thirty-five per cent of the entire cost of operating his home because he spent about that percentage of his time there preparing scripts. The deduction was in no way related to space used for business. "I get ideas," he told the examining agent, "wherever I am. They come to me when I'm lying flat on my back in bed, while I'm shaving or in the middle of dinner." The agent accepted the argument, and since then no other agent has questioned the percentage. But now the writer's home is a facility. Unless he can get more ideas, or get them more frequently, and thus increase his use to more than fifty per cent, he has probably lost his entire deduction.[54]

Of course, not all who use their homes for business will be as hard hit as this man. If specific space is set aside as an office and is only so used, the taxpayer can doubtless claim that such space is a separate facility devoted exclusively to his business. On this ground, the portion of his total home maintenance cost allocable to the separate space would remain deductible.[55]

III. Exceptions to the New Tests

Having established the seemingly rigid rules above set forth, Congress undertook in section 274(e) to enumerate nine exceptions to the rules. As to these, it will be unnecessary to prove either direct relationship to, or association with, the active conduct of a trade or business. If ordinary and necessary within the meaning of sections 162 and 212, these expenses will be deductible without reference to the new law.[56]

54. I do not intend to suggest that deductibility has usually depended upon specific space allocations. Percentage of business use may be determined by reference to time, volume of business, space or any other likely standard. Cf. Fred D. Newman, 11 CCH Tax Ct. Mem. 908 (1952); Wallace L. Chesshire, 11 CCH Tax Ct. Mem. 146 (1952); Emily B. Blanchard, 10 CCH Tax Ct. Mem. 1036 (1951); Ray Harroun, 4 CCH Tax Ct. Mem. 780 (1945).

55. N.Y. Times, Oct. 14, 1962, § 3, p. 14, col. 4.

56. The exceptions are as follows:

"(1) Business meals.—Expenses for food and beverages furnished to any individual under circumstances which (taking into account the surroundings in which furnished, the taxpayer's trade, business, or income-producing activity and the relationship to such trade, business, or activity of the persons to whom the food and beverages are furnished) are of a type generally considered to be conducive to a business discussion.

(2) Food and beverages for employees.—Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

(3) Expenses treated as compensation.—Expenses for goods, services, and facilities, to the

extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of chapter 24 (relating to withholding of income tax at source on wages).

(4) Reimbursed expenses.—Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such other person is his employer), under a reimbursement or other expense allowance arrangement with such other person, but this paragraph shall apply—

(A) where the services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (3), or

(B) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person.

(5) Recreational, etc., expenses for employees.—Expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are officers, shareholders or other owners, or highly compensated employees). For purposes of this paragraph, an individual owning less than a 10-percent interest in the taxpayer's trade or business shall not be considered a shareholder or other owner, and for such purposes an individual shall be treated as owning any interest owned by a member of his family (within the meaning of section 267(c)(4)).

(6) Employee, stockholder, etc., business meetings.—Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

(7) Meetings of business leagues, etc.—Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under section 501(a).

(8) Items available to public.—Expenses for goods, services, and facilities made available by the taxpayer to the general public.

(9) Entertainment sold to customers.—Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth."

All but the fourth and seventh of these exceptions in only slightly different form were recommended by the Treasury. House Hearings 283, 284-85. Of course, the Treasury was making its suggestion on the assumption that only the excepted items would thereafter be allowable as deductions. Moreover, the Secretary's explanation was careful to state that "no inference should be drawn . . . as to the deductibility of such expenses under section 162 . . . ." Id. at 283. The unfortunate use in the ninth exception of the term "an adequate and full consideration in money or money's worth" originated in the Treasury. Id. at 284. This is gift and estate tax language and means that "the price must have been an adequate and full equivalent reducible to a money value." Treas. Reg. § 20.2043-1(a) (1958). Woe betide the night club proprietor who offers his patrons a bargain. "[A]lmost all restaurant and most hotel entertaining" will not, by virtue of the first of the exceptions in § 274(e), be subject to either the "directly-related" or "associated-with" test. Conf. Rep. No. 2508, at 16. Since business need not actually be discussed at a "business meal," the Service may find it a little difficult to draw the line between expenses for food and beverages that are deductible and those "of a so-called reciprocity luncheon group" that are not. S. Rep. No. 1881, at 36. After all, one could discuss business with nearly anyone. But, as has already been suggested, if your guest is a competitor, it might be well to have something—like committee affairs—to discuss. J. Accountancy, Feb. 1963, p. 79.

A great deal of the force of the new statute is vitiated by these exceptions. If the criteria for deductibility under pre-1962 law were, as Congress obviously thought, too lax, the laxity continues with respect to a very high proportion of conventional entertainment expense. It is even possible that the law has been made a little less strict. The fact that expenditures of these general descriptions have been singled out and enumerated gives them, I think, a special quality which they did not have before. It is all very well to say that the taxpayer will still have the burden of proving them ordinary and necessary. The burden seems somehow to have been lightened, perhaps even shifted to the Government. For the implication of the exceptions is that Congress thought them likely to be ordinary and necessary and not abuses of the spirit of the law. They are, in other words, open invitations to spend money in the indicated ways.

IV. Gifts

The congressional treatment of business gifts was much less complex than that accorded entertainment expenses. No new criteria of deductibility were established. The cost of a gift still need be no more than an ordinary and necessary expense of doing business or engaging in the income-producing or other activities described in section 212. But under the new law the dollar amount of such an expense will be limited for income tax purposes to a relatively small figure—twenty-five dollars per year per donee.[57] If you want to hand out a mink coat to one of your more beautiful customers, you can still do it, but only the first twenty-five dollars of the coat's cost—plus packing, insurance and delivery charges[58]—will have any effect on your tax liability.

A gift in this context is defined (with certain minor exceptions) as "any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision" of Code Chapter 1.[59] An example of a gift that is not deductible beyond the limit is a payment to a deceased employee's widow on which she pays no tax because she successfully claims that what she has received is a gift. But if (or to the extent that) the payment to her

57. Int. Rev. Code of 1954, § 274(b).

58. H.R. Rep. No. 1447, at A31.

59. Int. Rev. Code of 1954, § 274(b). The exceptions are as follows:

"(A) an item having a cost to the taxpayer not in excess of $4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer, (B) a sign, display rack, or other promotional material to be used on the business premises of the recipient, or (C) an item of tangible personal property having a cost to the taxpayer not in excess of $100 which is awarded to an employee by reason of length of service or for safety achievement."

falls within the exclusion provided in section 101(b), the twenty-five dollar limit does not apply.[60]

By making the deductibility of a charge on the return of one taxpayer depend upon the ultimate treatment of the corresponding credit on the return of another, the statute introduces a new element of uncertainty in one's computations. To be sure, the recipient of a payment must, in establishing his right to exclude it from income as a gift, offer evidence with respect to the intent of the alleged donor. But the donor himself is, at best, only a witness in this proceeding. He is, therefore, neither expected nor permitted to volunteer his own view of the matter. The committee reports are careful to assert at the outset, in their discussion of section 274, that it "does not affect the question of the includibility or excludibility of an item in income of any individual."[61] Notwithstanding this disclaimer, the necessary inference from a taxpayer's attempt to avoid the dollar limitation of the gift subsection would, in some instances, appear to be the inclusion of the expense incurred in the income of the recipient.

The statute provides that, in the case of gifts made by a partnership or any of its members with respect to partnership business, only one twenty-five dollar deduction will be allowed for each donee: a favorite customer cannot expect one bottle of Chanel No. 5 from the firm and another from each partner—unless, of course, her dealings with each partner are unrelated to the business of the firm and of each other partner.[62] Similarly, husband and wife will be treated as one in their gift giving.[63]

When it comes to receiving, the Code speaks of gifts made "directly or indirectly to any individual. . . . "[64] The legislators' construction of this phrase is a little fuzzy. At one point, the reports tell us that gifts "made to the wife of a man who has a business contact with the donor, . . . are considered as made indirectly to the husband";[65] at another, this is softened to apply the statutory limitation merely "where the gift is intended for the eventual use" of the husband.[66] The reports also say that husband and wife will not be considered a single donee if they happen to be partners in a business.[67] Like other deliberately enigmatic terms of the tax law, "directly and indirectly" in section

60. H.R. Rep. No. 1447, at A31.
61. H.R. Rep. No. 1447, at 19-20.
62. Int. Rev. Code of 1954, § 274(b)(2)(A); see also H.R. Rep. No. 1447, at A31-32.
63. Int. Rev. Code of 1954, § 274(b)(2)(B).
64. Int. Rev. Code of 1954, § 274(b)(1).
65. S. Rep. No. 1881, at 33.
66. H.R. Rep. No. 1447, at A31.
67. H.R. Rep. No. 1447, at A32.

274(b) is probably a portmanteau, always ready to mean whatever the reader chooses.

V. Travel Expense

The third theme of section 274 is that of the expenses of travel away from home incurred "in pursuit of a trade or business or . . . an activity described in section 212. . . . "[68] Congress here made two changes in the pattern of the law.

According to the regulations, under prior law such expenses were allowed in full if they were "reasonable and necessary . . . and directly attributable" to the taxpayer's business or (presumably) section 212 activity.[69] In the case of a mixed business and pleasure trip, deductions were allowed "only if the trip [was] . . . related primarily to the taxpayer's trade or business."[70] The question of primary relationship was tested in the first instance on a time basis, and, in the absence of clear contrary evidence, where more of the time away from home had been spent in personal activities than in doing business, there was no deduction at all.[71]

The first change made by the new law is to require an allocation between business and personal travel in all cases where the trip lasts more than a week and twenty-five per cent or more of the taxpayer's time is not attributable to the pursuit of business or section 212 activity. In this event, the percentage of the total cost equal to the percentage of total time devoted to nonbusiness pursuits will not be deductible.

The Finance Committee illustrated the differences between existing law and the new rule as follows:

Example 1.—Taxpayer A flew from New York to London where he conducted business for 2 days. A then flew to Stockholm for a 14-day vacation after which he flew back to New York from Stockholm. The trip took 18 days, 2 of which were attributable to the flight to London and return. A would not have made the trip except for the business he had to conduct in London. Under present law A could deduct the entire cost attributable to transportation and food to and from London and the food and lodging during the 2 days spent on business in London. The traveling expenses attributable to the vacation part of his trip including transportation, food, and lodging would not be deductible under present law. Such personal expenditures would also not be deductible under section 274(c) in the bill. In addition under such section, since the travel away from home exceeded a week and the time devoted to personal activities was not less than 25 percent of the total time away from home, it is contemplated that the regulations will provide that fourteen-eighteenths (14 days devoted to personal activities out of a total of 18 days away from home on the trip) of the costs attributable to transportation and food to and from London are to be disallowed. The de-

68. Int. Rev. Code of 1954, § 274(c).
69. Treas. Reg. § 1.162-2(a) (1958).
70. Treas. Reg. § 1.162-2(b)(1) (1958).
71. Treas. Reg. § 1.162-2(b)(2) (1958).

ductibility of cost of the food and lodging during the 2 days spent on business in London would be determined under section 162(a)(2), as amended by the bill.[72]

Nice questions will doubtless arise in computing the percentages of business and personal time. Suppose in the above example, the taxpayer's doctor had not allowed him to fly and he therefore went to Europe by ship. Would his travel time still be counted as business time? Suppose the two days of business had occurred in Stockholm after two weeks in Paris. Would this have any effect on the amount deductible for transportation? Speculations of this sort will consume time as returns are prepared and later audited, and some of them may be resolved in rulings so as to become part of the higher learning of the tax law. But one doubts that the resolution of such questions will contribute greatly to our public revenues.

The new rule does not make deductible anything that was not deductible before.[73] Travel away from home will still have no effect on one's income tax liability if it is not "related primarily" to business or other income-producing activity. The taxpayer who, in the example of the regulations, spends one week on business and five on vacation will still be presumed to have been on a frolic. He therefore will not be allowed a deduction for any part of the cost of his transportation to and from his destination, or, indeed, any other expenses incurred while there if it appears they would have been incurred whether or not he had done any business.

There has apparently been no change in the general rule with respect to expenses arising from the presence of the taxpayer's wife or some other member of his family. If "it can be adequately shown that the wife's presence on the trip has a bona fide business purpose," these will be allowed as deductions[74]—subject, however, to the new allocation principle. The fact that the taxpayer was accompanied by his wife should not of itself reduce the amount of his deduction for the trip, even though the total cost of joint transportation, lodging, and so forth, is less than twice what it would have been had the husband travelled

72. S. Rep. No. 1881, at 172-73. It has been reported that § 274, and particularly that part of it restricting the deductibility of travel expenses, may well be modified in the current session of Congress. The "inequity" of the travel rule is illustrated by the case of "a corporation employee who takes a flying trip to Chicago to sign a $1 million contract, and is detained for two weeks because his mother there had a stroke." This man would have to pay two-thirds of the cost of his round-trip ticket while another who went to Chicago to sign a contract resulting in a $100,000 loss and spent six days "in riotous living in Chicago" would be able to have his company pick up (and deduct) the full round-trip fare. Wall Street Journal, March 1, 1963, p. 3, cols. 2-3.

73. S. Rep. No. 1881, at 34, 172.

74. Treas. Reg. § 1.162-2(c) (1958).

alone.[75] As a matter of logic, however, the wife's presence might make it more difficult to establish the trip's primary relationship to business.

A taxpayer may, of course, escape allocation of his travel expense if he can so arrange his trips as to make none of them last more than a week. He may have more difficulty over the second statutory change in this area. This consists of a sort of metaphysical limit on travel expenses. Henceforth, these will not be allowable as deductions if they are "lavish or extravagant under the circumstances."[76]

It is reasonable to suppose this means that only the portion of these expenses deemed to be lavish or extravagant will be disallowed. The fact that a taxpayer has stayed in a hotel twice as expensive as he should have or eaten a meal in a restaurant of the more recherché sort should not result in total disallowance. But this is only a guess.

Needless to say, no one has defined what lavish or extravagant expenses are. It has been suggested that the income and way of life of the taxpayer will be just as much a determining factor as the nature of the accommodations available.[77] Equally determinative will be the personal attitudes of examining agents and judges. Those, for example, who fancy themselves as gourmets may find nothing wrong with a forty-dollar dinner for two if the right chef prepared it.

One can but deplore the introduction of undefined accusatory terms into a tax statute. They seem to have little value except as a weapon for the Internal Revenue Service. They are sure to produce controversy and probably litigation. They will be applied hundreds of times to particular situations and, if they remain in the statute, they will probably mean nothing more definite ten or twenty years from now than they do today.[78]

VI. Substantiation

To the tax practitioner, the worst part of section 274 is that entitled "Substantiation Required"—subsection (d)—which reads in its entirety as follows:

> No deduction shall be allowed—
>
> (1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

75. Rev. Rul. 56-168, 1956-1 Cum. Bull. 93, 94.

76. Int. Rev. Code of 1954, § 162(a)(2).

77. Skinner, 1962 Act: Burdens Imposed by T & E Rules Require New Expense Account Practices, 17 J. Taxation 360, 365 (1962).

78. Do we know any more concerning the meaning of "ordinary and necessary" today than we did forty-five years ago when it first entered the tax law? An editorial writer has suggested that, in determining what is lavish, "the metaphysicians of the Internal Revenue Service . . . are finding it no easier than the metaphysicians of the Puritan past who tried to decide how many inches of lace on a lady's petticoat constitute a lavish—or lascivious—display." Wall Street Journal, Jan. 21, 1963, p. 16, col. 1.

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, or

(3) for any expense for gifts,

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

This new rule overrules the old one, first enunciated by Judge Learned Hand in *Cohan v. Commissioner*,[79] that where a taxpayer has established that he has made expenditures for entertainment or travel and that such expenditures were deductible he cannot be denied a deduction merely because the taxpayer is unable to prove how much he spent.[80]

The Internal Revenue Service has found the application of the *Cohan* rule enormously burdensome. Many taxpayers fail to keep records to support travel and entertainment deductions "even though they maintain excellent records with respect to all other business expenses."[81] There is no satisfactory way of estimating what may have been spent for entertainment, and the guesses of revenue agents nearly always antagonize taxpayers.[82] If the taxpayer emerges from an audit with allowances in excess of his expenditures, he claims even more in later returns and tells his friends that "the more you claim. . . , the more you will be allowed."[83]

79. 39 F.2d 540 (2d Cir. 1930).

80. Mr. Cohan failed to prove not only the amount of his traveling and entertainment expenses but also the portion thereof which was personal and therefore not deductible. George M. Cohan, 11 B.T.A. 743, 761 (1928). It is the application of the rule to supply a deficiency of proof in this latter area that, in this author's judgment, has been the rule's chief vice. Section 274(d) does not completely overrule the Cohan decision for it has been cited in support of allowing deductions for expenses other than T & E and presumably for these it will continue to be authoritative. See, e.g., Martin J. Lichterman, 37 T.C. 586 (1961) (medical expenses).

81. House Hearings 162.

82. Id. at 155.

83. Id. at 156. The Internal Revenue Service has certainly on occasion been overgenerous in its application of the Cohan rule and there seems no good reason for its acceptance of the rule at the administrative level. Why could you not take the position that whenever a taxpayer cannot prove what he spent he must, in order to be allowed any deduction at all, look to the courts? This policy would at least avoid embarrassment for the Service. See Challenge Mfg. Co., 37 T.C. 650 (1962).

In theory, at least, this will no longer be the case. If the Service can manage to enforce the new law, no taxpayer is going to be allowed a travel, entertainment or gift deduction "solely on the basis of his own unsupported, self-serving testimony."[84]

What the Service insists we must all from now on maintain and produce in support of any of these deductions is "such substantiation as will constitute clear proof of . . . each element of such an expenditure."[85] The elements of an expenditure are the four aspects enumerated in section 274(d), namely, amount, time and place, business purpose and business relationship.

In most cases, amount will be established by documentary evidence—receipted and itemized bills. These will not be required for expenditures (except for lodging while traveling away from home) of less than twenty-five dollars, nor will documentary proof of any transportation expense be expected where such proof is not readily available.[86]

The amounts for which receipted bills will not be required, as well as the remaining elements of each expense, will be deemed proved if the taxpayer has a diary or similar record in which the necessary information was entered at or near the time of the expenditure.[87] The Service has published the following examples of the diary entries it has in mind:

1-3-63: Lunch and tip—$17.00; Cafe Plaza, New York, N.Y.; with Jones, Brown, Green & Smith, trustees of Modern Real Estate Investment Trust concerning architectural plans for Claremont Village Apts.[88]

1-3-63: Taxi and tip ($2.55); Drinks at bar and tip ($14.00), dinner ($24) and tip ($4) at Flair Club, Washington, D.C.; entertainment of president Black, vice president Chum, and treasurer Drew of the Acme Corp., following business meeting with them at my office all afternoon concerning proposed distributorship arrangement between Y and Acme Corporations.[89]

The first of these substantiates entertainment expense "directly related" to the taxpayer's business while the second covers such an expense that is "associated with" the business.

Entries acceptable as establishing the required use of a facility would, when accompanied by the necessary documentary evidence, run as follows:

Month of January, 1963:

Jan. 6—Lunch with John Jones (general manager Doe Construction Co., Boston) regarding equipment rental contract for building at 14th and H Streets.

84. H.R. Rep. No. 1447, at 23.

85. Treas. Reg. § 1.274-5(c)(1) (1962).

86. Treas. Reg. § 1.274-5(c)(2)(iii) (1962).

87. Treas. Reg. § 1.274-5(c)(2)(ii) (1962).

88. Rev. Proc. 63-3, 1963 Int. Rev. Bull. No. 4, at 33 (Example (2)).

89. Id. at 33 (Example (3)).

Jan. 7—Family use.
Jan. 10—Personal lunch.
Jan. 15—Lunch with Ed Filbert (president, Central Development Corp., Hartford) regarding building at 37th and Q Streets.
Jan. 18—Family use.
Jan. 20—Lunch with Robert Smith (superintendent Young Construction Co., Boston) discussed building at 20th and A Streets.
Jan. 26—Personal use.
Jan. 28—Lunch with Jim Green (treasurer, Roe Construction Co., Quincy) to discuss equipment for building at 20th and A Streets.[90]

In the absence of proof of this sort as to any of the elements of an expense, other evidence will be permissible if it has a "high degree of probative value."[91] This will include statements in writing or oral testimony from the persons entertained or others where the unproved element is the cost, time, place or date of the expenditure. Circumstantial evidence will be acceptable if the question is merely one of business purpose or business relationship.[92]

The difficulty with these new rules from the practitioner's point of view is that they are not self-executing. Somebody—and the tax lawyer or accountant suspects it is he—is going to have to convince the clients that compliance is essential. This will not be easy. What sort of diary can we expect of a taxpayer who for years has decided what to claim as entertainment deductions by making a wild guess on April 10th and who has regularly supported his claims upon audit with a batch of cancelled checks of dubious relevance and a firm statement that he would never belong to that club if it were not for the business contacts he made there? But if we cannot persuade this man to keep proper records, how are we going to be able to assist in the preparation of his returns? For under the new rules he will not merely be risking the disallowance of a questionable claim. If the evidence does not exist there can be no claim. "[U]nless the taxpayer substantiates," the statute says, "*no deduction shall be allowed.*"[93] And since the taxpayer must know

90. Id. at 33 (Example (4)).

91. Treas. Reg. § 1.274-5(c)(1) (1962).

92. Treas. Reg. § 1.274-5(c)(3) (1962). The requirements of the substantiation regulations have been vigorously protested in Congress. Senator Smathers has been quoted as declaring that they "impose detail on top of detail and then top it all off by requiring so much proof that in my opinion the taxpayer must prove his case beyond a reasonable doubt. That's for criminal law, . . . not the tax law." Wall Street Journal, March 1, 1963, p. 3, col. 4.

93. Int. Rev. Code of 1954, § 274(d). (Emphasis added.) The proposed (but not the final) substantiation regulations provided that "a taxpayer claiming a deduction on his return with respect to an expenditure for travel, entertainment, or gifts, shall state on his return whether he has substantiation for such expenditure of the sort specified in the regulations." Proposed Treas. Reg. § 1.274.5(c)(4)(v), 27 Fed. Reg. (1962). Since all statements in a return are made "under the penalties of perjury," it would appear that the Treasury's original idea was to establish the ground for fraud charges at the outset.

whether or not he has the necessary proof, his claim where such proof does not exist is perilously close to, and may actually be, a fraud.

A lawyer or accountant who prepares a return will have the burden, I think, of asking his client whether the records do exist. And if the client says they do not, the lawyer or accountant should refuse to prepare a return on which expenses for travel, entertainment or gifts are claimed. This is an unpleasant sort of position to take. It tends to lose clients. Even worse, it makes one look horribly stuffy. But is there any reasonable alternative?

VII. Conclusion

It has been argued that section 274 has added nothing of any substance to the law.[94] Exponents of this view point to any number of cases in which the courts have used language strikingly similar to that of the Ways and Means and Finance Committee reports on the 1962 act.[95] And reading these cases one does begin to think that the limits on deductibility were hardly more confining then than they are now.

It is possible, however, that the directly-related and associated-with tests will make it necessary to prove exactly how beneficial entertainment has been in terms of money. If John Jones was taken to dinner, just how many widgets did John Jones buy? If you took Robert Smith out on your boat, did he become a client of your law firm? These are questions that have not been asked before. Their answers may determine the size of future deficiencies.

The procrustean approach to gift deductions will certainly discourage the more widely publicized abuses, and should not make any but the greedy unhappy.

One can scarcely quarrel with the congressional effort to squeeze the personal element out of travel deductions, and this may be the only real effect of the new allocation principle and the ban on the lavish and extravagant.

The substantiation requirements may seem burdensome now, but should in time make life for all of us simpler and happier. Record-keeping is a natural concomitant of business life, and if a businessman spends so much time in entertainment that writing up his diary is unduly time-consuming, it seems necessary to ask who is minding the store. Moreover, there will be no more of a quarrel over "T & E" at audits than there is now over taxes, interest or medical expense.

94. Rephan, 1962 Act: Is The "Directly Related" Test For Entertainment Expenses Really New?, 17 J. Taxation 366 (1962); Grossman, The Impact of the Revenue Act of 1962 on Travel and Entertainment Expenses and Business Gifts, 40 Taxes 1047 (1962).

95. See, e.g., Robert Lee Henry, 36 T.C. 879 (1961); Long v. Commissioner, 277 F.2d 239 (8th Cir. 1960), affirming 32 T.C. 511 (1959); Louis Boehm, 35 B.T.A. 1106 (1937).